

## Message Text

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ORIGIN SS-25

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DRAFTED BY CEA: J SHAFER; EUR/RPE: R S GELBARD:VS  
APPROVED BY EUR: G VEST  
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S/S:O:TMARTIN

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TO AMEMBASSY BONN IMMEDIATE  
AMEMBASSY BRUSSELS IMMEDIATE  
AMEMBASSY LONDON IMMEDIATE  
AMEMBASSY OTTAWA IMMEDIATE  
AMEMBASSY PARIS IMMEDIATE  
AMEMBASSY ROME IMMEDIATE  
AMEMBASSY TOKYO IMMEDIATE

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EXDIS, FOR USEEC

E.O. 11652: GDS

TAGS: ECON, OCON

SUBJ: SUMMIT MACROECONOMICGROUP : MAIN TEXT  
FROM CEA CHAIRMAN CHARLES SCHULTZE

1. POSTS SHOULD PASS TEXT DETAILED BELOW TO OTHER MACRO-  
ECONOMIC GROUP PARTICIPANTS (TIETMEYER, MOSCA, WASS, HOOD,  
HABERER, PALUMBO, MIYAZAKI). SEPTTEL FOLLOWS CONTAINING  
COUNTRY NOTES AND TABLE.

2. I AM ATTACHING A DRAFT OF A MACROECONOMIC ASSESSMENT  
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FOR US TO CONSIDER WHEN WE MEET NEXT WEEKEND, MAY 20-21,  
IN WASHINGTON. IN ADDITION, I AM SENDING SHORT NOTES THAT  
SUMMARIZE THE SITUATION IN EACH OF OUR COUNTRIES AND A  
TABLE SHOWING RECENT GROWTH AND WHAT APPEARS TO BE THE  
CONSENSUS OF PRIVATE FORECASTS FOR GROWTH IN 1978. THE  
SUMMARIES AND TABLE ARE INTENDED FOR DISCUSSION PURPOSES AND  
ARE FOR THE USE OF THE GROUP ONLY.

3. THE ASSESSMENT LACKS A FINAL SUMMATION OF THE POLICY MEASURES IT WOULD BE APPROPRIATE FOR OUR COUNTRIES TO REVIEW PRIOR TO THE BONN MEETING OF HEADS OF GOVT. IT WOULD HELP US TO COMPLETE SUCH A SUMMATION AND PROVIDE A BASIS FOR FURTHER DISCUSSIONS WITHIN OUR GOVERNMENTS IF EACH OF US COULD BE PREPARED TO ADDRESS THE FOLLOWING QUESTIONS

WHEN WE MEET.

1. WHAT IS THE DOMINANT CONSTRAINT ON IMPROVED ECONOMIC PERFORMANCE IN YOUR ECONOMY THROUGH 1979? WHERE INTERNAL, DISTINGUISH BETWEEN THE INFLATION CONSTRAINT AND CONSTRAINTS ON EFFECTIVENESS OF POLICIES.

2. IF YOUR DOMINANT CONSTRAINT IS AN EXTERNAL ONE, HOW MUCH LEEWAY WOULD YOU GAIN IF IT WERE REMOVED BEFORE OTHER CONSTRAINTS BECAME BINDING? MORE SPECIFICALLY, BY HOW MUCH WOULD YOU BE ABLE TO INCREASE YOUR GROWTH?

3. WHAT ACTIONS BY OTHER COUNTRIES WOULD LOOSEN THE EXTERNAL CONSTRAINTS AND POLICY CONSTRAINTS THAT YOUR ECONOMY FACES?

4. WHAT POLICIES MIGHT YOUR GOVERNMENT CONSIDER TO RAISE THE RATE OF FIXED INVESTMENT IN YOUR  
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ECONOMY?

5. WHAT POLICIES, IN ADDITION TO DEMAND MANAGEMENT POLICIES, DO YOU SEE AS USEFUL IN BRINGING DOWN THE RATE OF INFLATION IN YOUR ECONOMY? TO WHAT EXTENT IS YOUR ECONOMY LIMITED BY POLICY INSTRUMENTS AVAILABLE?

4. I PROPOSE THAT AT OUR MEETING: A) WE FIRST HAVE A GENERAL DISCUSSION OF THE OVERALL ECONOMIC SITUATION AS SET FORTH IN THE DRAFT ASSESSMENT AND THE ANNEXES; B) THEN DISCUSS QUESTIONS 1-5 SET FORTH ABOVE; C) FINALLY, WE DISCUSS HOW THE DRAFT SHOULD BE MODIFIED AND COMPLETED IN LIGHT OF OUR DISCUSSIONS. I WOULD HOPE TO HAVE A FINAL DRAFT ON SUNDAY MORNING FOR THE GROUP TO APPROVE. WE SHOULD ALSO TAKE SOME TIME ON SUNDAY TO CONSIDER HOW OUR GOVERNMENTS SHOULD PROCEED OVER THE SUBSEQUENT SIX WEEKS TO LAY THE FOUNDATION FOR A CONSTRUCTIVE SUMMIT OUTCOME WITH RESPECT TO MACROECONOMIC POLICIES.

5. WE WILL MEET NEXT SATURDAY, MAY 20, IN ROOM 248 OF THE OLD EXECUTIVE OFFICE BUILDING, 17TH STREET AND PENNSYLVANIA AVENUE, N.W. I SUGGEST WE BEGIN AT 10:00 A.M. AND WOULD

EXPECT OUR MEETING TO GO UNTIL ABOUT 6:00 P.M. I HAVE ARRANGED FOR US TO HAVE LUNCH ON SATURDAY IN THE WHITE HOUSE MESS. WE CAN SET A TIME TO RECONVENE ON SUNDAY IN VIEW OF THE PROGRESS WE HAVE MADE.

6. I AM SINCERELY LOOKING FORWARD TO SEEING YOU AT THE MEETING.

BEGIN TEXT: MACROECONOMIC ASSESSMENT

THIS REPORT HAS BEEN PREPARED BY A GROUP CONVENED BY CEA CHAIRMAN CHARLES SCHULTZE OF THE UNITED STATES AT THE REQUEST OF THE PREPARATORY GROUP FOR THE BONN SUMMIT. THE GROUP INCLUDED REPRESENTATIVES FROM THE SEVEN LARGEST IN-SECRET

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DUSTRIAL COUNTRIES AND THE EC COMMISSION (A LIST OF PARTICIPANTS IS ATTACHED). THE GROUP MET IN WASHINGTON ON MAY 20-21 TO ASSESS THE CURRENT MACROECONOMIC SITUATION AND FUTURE PROSPECTS IN THEIR COUNTRIES AND TO CONSIDER WHAT POLICY MEASURES MIGHT BE CONSIDERED IN LIGHT OF THESE CIRCUMSTANCES.

THE GROUP RECOGNIZED THAT THEIR OWN ECONOMIES AND THE WORLD ECONOMY HAVE NOT YET FULLY RECOVERED FROM OR ADJUSTED TO THE SHOCKS OF THE EARLY 1970S, WHICH GAVE RISE TO AN UP-SURGE OF INFLATION, THE EMERGENCE OF UNPRECEDENTED DEFICITS IN THE CURRENT ACCOUNTS OF MANY COUNTRIES, AND THE DEEP WORLDWIDE RECESSION OF 1974-75.

IN A NUMBER OF RESPECTS THERE HAS BEEN A MARKED IMPROVEMENT IN CONDITIONS IN OUR OWN ECONOMIES AND ELSEWHERE SINCE 1975.

-- INFLATION RATES IN OUR SEVEN COUNTRIES, WHICH RANGED FROM 6 PERCENT TO 25 PERCENT IN 1975 HAVE BEEN BROUGHT DOWN TO A RANGE FROM 3 PERCENT TO 13 PERCENT.

-- CUMULATIVE REAL OUTPUT GAINS AVERAGED 9.7 PERCENT FROM 1975 TO 1977.

-- SOME COUNTRIES WHOSE EXTERNAL FINANCIAL POSITIONS WERE EXTREMELY PERILOUS HAVE ACHIEVED SIGNIFICANT IMPROVEMENTS IN THEIR PAYMENTS POSITIONS.

IN ADDITION, SERIOUS THREATS TO THE STABILITY OF THE WORLD ECONOMY HAVE BEEN AVERTED. DESPITE PRESSURES GENERATED BY UNPRECEDENTED PAYMENTS IMBALANCES AND DEPRESSED LEVELS OF EMPLOYMENT AND OUTPUT, A LIBERAL WORLD TRADING SYSTEM  
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HAS BEEN MAINTAINED ESSENTIALLY INTACT, AND THE MOMENTUM FOR FURTHER REDUCTION OF TRADE BARRIERS IN THE TOKYO FOUND OF TRADE NEGOTIATIONS HAS BEEN SUSTAINED.

THE ECONOMIC PROBLEMS THAT STILL FACE US ARE SERIOUS, HOWEVER.

-- OUR ECONOMIES CONTINUE TO FALL SHORT OF THEIR PRODUCTIVE POTENTIAL AND IN MANY OF OUR COUNTRIES THE GAPS HAVE

WIDENED IN THE PAST YEAR. THE SMALLER INDUSTRIAL COUNTRIES HAVE HAD EVEN MORE DISAPPOINTING RECOVERIES IN OUTPUT AND THE DEVELOPING COUNTRIES HAVE NOT YET RECOVERED FROM THE SERIOUS SETBACKS THE RECESSION DEALT THEIR DEVELOPMENT PROGRAMS.

-- THE UNEMPLOYED CONSTITUTE A GREATLY EXPANDED GROUP COMPARED WITH THE RECORD OF THE FIFTEEN YEARS PRIOR TO 1975.

-- PRODUCTIVE INVESTMENTS ARE CURRENTLY ACCOUNTING FOR SMALLER SHARES OF TOTAL OUTPUT IN OUR COUNTRIES. HENCE THE GROWTH OF PRODUCTIVITY HAS BEEN IMPAIRED AND FUTURE EMPLOYMENT OPPORTUNITIES HAVE BEEN REDUCED.

-- ALTHOUGH REDUCED FROM PEAK LEVELS, CONTINUED HIGH INFLATION RATES IN MOST OF OUR COUNTRIES AND IN MANY SMALLER COUNTRIES POSE A CONTINUING THREAT TO ECONOMIC STABILITY AND A CONSTRAINT ON MORE RAPID RECOVERY.

-- NEW AND MORE SUBTLE FORMS OF PROTECTION ARE BEING INTRODUCED, THREATENING BOTH THE HEALTH OF THE INTERNATIONAL TRADING SYSTEM AND THE LONGER TERM RISE IN LIVING STANDARDS.

-- SOME IMPORTANT IMBALANCES IN CURRENT ACCOUNTS PERSIST AND NEW ONES HAVE EMERGED OR BECOME MORE SERIOUS.

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CURRENT ECONOMIC CONDITIONS AND THE OUTLOOK FOR THIS YEAR AND NEXT

IN 1977 THE GROWTH OF REAL GNP IN OUR ECONOMIES AVERAGED 3.9 PERCENT. GROWTH IN THE EUROPEAN COMMUNITY WAS ONLY 2 PERCENT. EXCEPT FOR THE UNITED STATES THE GROWTH OF INDUSTRIAL OUTPUT WAS LESS THAN TOTAL GNP GROWTH AS SHARES

OF GOVERNMENT AND OTHER SERVICES IN GNP ROSE. UNEMPLOYMENT WAS UNCHANGED OR ROSE IN 1977 EXCEPT IN THE UNITED STATES. THUS, IN EARLY 1978, UNEMPLOYMENT RATES IN ALL COUNTRIES STOOD SUBSTANTIALLY ABOVE THE AVERAGE UNEMPLOYMENT RATE FOR THE TEN YEARS PRIOR TO THE 1975 RECESSION. INDEED, EXCEPT FOR GERMANY AND THE UNITED STATES, UNEMPLOYMENT RATES NOW STAND ABOVE THOSE RECORDED AT THE RECESSION TROUGH. THE UNITED STATES HAS ACHIEVED A REDUCTION IN ITS UNEMPLOYMENT RATE OF 3 PERCENTAGE POINTS SINCE MID-1975.

SEVERAL DEVELOPMENTS, WHICH VARY IN IMPORTANCE FROM COUNTRY TO COUNTRY, HAVE MEANT THAT THE LOWEST UNEMPLOYMENT RATES THAT COULD BE ACHIEVED WITHOUT ACCELERATING INFLATION ARE SOMEWHAT HIGHER NOW THAN IN THE 1960S. THESE DEVELOPMENTS INCLUDE RAPID GROWTH IN THE NUMBERS OF YOUNG

PEOPLE AND WOMEN ENTERING LABOR MARKETS, HIGHER LEVELS OF INCOME MAINTENANCE PROGRAMS FOR THE UNEMPLOYED, AND SLOW RATES OF CAPITAL FORMATION COMBINED WITH RAPID LABOR FORCE GROWTH. NOWHERE, HOWEVER, DO THESE FACTORS ACCOUNT FOR THE FULL INCREASE IN UNEMPLOYMENT RATES. SUBSTANTIAL SCOPE REMAINS FOR EXPANSION OF EMPLOYMENT AND OUTPUT BEFORE LABOR MARKET TIGHTNESS WOULD LEAD TO ACCELERATING INFLATION.

REAL GROWTH IN OUR ECONOMIES MAY AVERAGE 3.5 TO 4 PERCENT IN 1978, BUT OUTSIDE THE UNITED STATES UNEMPLOYMENT  
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IS UNLIKELY TO BE REDUCED. GROWTH IN OTHER INDUSTRIAL COUNTRIES WILL AVERAGE SUBSTANTIALLY LOWER. SOME RECOVERY IN ECONOMIC ACTIVITY OCCURRED IN LATE 1977 AND EARLY THIS YEAR IN THOSE ECONOMIES THAT HAD BEEN PARTICULARLY DEPRESSED, BUT THE HOPED FOR CONTINUED ACCELERATION TO MORE RAPID GROWTH RATES IN EUROPE AND JAPAN IS NOW IN DOUBT. GROWTH OF THE U.S. ECONOMY, DESPITE A POOR FIRST QUARTER, SHOULD REMAIN ABOVE THE GROWTH RATE OF POTENTIAL OUTPUT BUT AVERAGE MUCH LESS THAN IN 1977 AS LABOR CONSTRAINTS BEGIN TO LOOM CLOSER. THUS, WITH NO ADJUSTMENTS OF POLICIES, ACTUAL GROWTH WOULD BE LESS THAN EXPECTED EARLIER IN GERMANY, JAPAN, AND THE UNITED STATES. MOREOVER, IN NONE OF OUR COUNTRIES WOULD GROWTH EXCEED TARGETS SET EARLIER.

THE OUTLOOK FOR GROWTH IN 1979 DOES NOT APPEAR SIGNIFICANTLY DIFFERENT FROM 1978. PROFITS AND CAPACITY UTILIZATION RATES DO NOT CURRENTLY SEEM FAVORABLE TO SIGNIFICANTLY STRONGER GROWTH OF INVESTMENT, AND CONSUMER SAVINGS RATES ARE UNLIKELY TO COME DOWN SHARPLY. THUS MANY OF OUR COUNTRIES COULD ENTER A THIRD YEAR IN WHICH NO PROGRESS IS MADE IN CLOSING SIZEABLE OUTPUT GAPS.

OUTSIDE OF NORTH AMERICA SIGNIFICANT DECLINES IN INFLATION OCCURRED IN 1977 AND HAVE CONTINUED INTO EARLY 1978. THESE IMPROVEMENTS HAVE BEEN ASSOCIATED WITH A SLOWING OF NOMINAL WAGE INCREASES AND A REDUCTION OF UNDERLYING INFLATION TRENDS, BUT PART OF THE IMPROVEMENT FROM 1976 TO 1977 IN SEVERAL COUNTRIES IS ATTRIBUTABLE TO CONTRASTING EXCHANGE RATE DEVELOPMENTS IN THE TWO YEARS. ALTHOUGH THE CANADIAN AND U.S. INFLATION RECORDS PROVIDE LITTLE HOPE THAT THE UNDERLYING TRENDS OF PRICES AND WAGES IN THESE COUNTRIES WILL BE REDUCED, MOST OF THE MODEST INCREASE IN THEIR INFLATION RATES IS ATTRIBUTABLE TO INCREASES IN FOOD PRICES AND THE EFFECTS OF EXCHANGE RATE CHANGES. THESE MOVEMENTS ARE UNLIKELY TO BE REVERSED, BUT THEIR  
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CONTRIBUTION TO INFLATION RATES SHOULD SUBSIDE IN THE PERIOD AHEAD.

INFLATION MAY DECLINE FURTHER IN THE MONTHS AHEAD IN ITALY, THE UNITED KINGDOM, AND FRANCE BUT A BOTTOMING OUT COULD WELL OCCUR DURING 1978. INFLATION IN GERMANY AND JAPAN IS UNLIKELY TO HOLD AT THE VERY LOW RATES OF RECENT MONTHS, BUT RECENT WAGE DEVELOPMENTS ARE FAVORABLE TO RELATIVELY MODERATE INFLATION THROUGH THE REST OF THE YEAR.

FOR OUR COUNTRIES TO ACHIEVE REDUCTIONS IN INFLATION RATES IN 1979 WILL REQUIRE FAVORABLE DEVELOPMENTS IN NOMINAL WAGES AND PRODUCTIVITY PERFORMANCE. FOR MANY COUNTRIES THE MOST LIKELY OUTCOME IS THAT PRICE RISES WILL BE AS LARGE IN 1979 AS IN 1978. THE UNITED STATES AND CANADA, WHICH ARE MOST LIKELY TO POST SOME INCREASE IN INFLATION RATES THIS YEAR, MAY BE MORE LIKELY TO SHOW A SMALL DECLINE NEXT YEAR.

CURRENT ACCOUNT IMBALANCES REMAIN BOTH A REFLECTION OF THE INSTABILITY OF THE WORLD ECONOMY AND A SOURCE OF ADDITIONAL INSTABILITY. THE EXTERNAL BALANCE SITUATION HAS EVOLVED RAPIDLY, HOWEVER, AND THE FOCUS OF CONCERNS HAS SHIFTED. THE OPEC SURPLUS HAS DECLINED SUBSTANTIALLY, AND, ALTHOUGH STILL LARGE, IT DOES NOT DOMINATE THE GLOBAL PATTERN OF CURRENT ACCOUNTS AS IT DID. THIS SURPLUS, WHICH EXCEEDED 60 BILLION DOLLARS IN 1974, DECLINED TO APPROXIMATELY 35 BILLION DOLLARS IN 1977 AND WILL PROBABLY BE IN THE VICINITY OF 20-25 BILLION DOLLARS THIS YEAR. A LITTLE MORE THAN A YEAR AGO THE EXTERNAL DEFICITS OF THE UNITED KINGDOM AND ITALY WERE THE IMBALANCES OF GREATEST CONCERN AMONG OUR COUNTRIES, BUT IN THE PAST YEAR BOTH COUNTRIES HAVE MOVED INTO CURRENT ACCOUNT SURPLUS, ALTHOUGH THE STAGNATION OF DOMESTIC INDUSTRIAL ACTIVITY THAT IS PARTLY RESPONSIBLE  
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FOR THESE SURPLUSES MEANS THAT THE FUNDAMENTAL ADJUSTMENTS THAT HAVE OCCURRED ARE LESS THAN MIGHT FIRST APPEAR. ALSO, THE LARGE CURRENT ACCOUNT DEFICIT OF FRANCE, WHICH HAD BEEN SEEN AS A SIGNIFICANT CONSTRAINT ON ECONOMIC POLICIES THERE, HAS BEEN REDUCED. AT THE SAME TIME, THE JAPANESE SURPLUS AND U.S. DEFICIT ON CURRENT ACCOUNT HAVE GROWN PHENOMENALLY, AND A SIZEABLE GERMAN SURPLUS AND LARGE CANADIAN DEFICIT RELATIVE TO GNP HAVE PERSISTED. THE DEFICITS OF SOME OF THE SMALLER INDUSTRIAL COUNTRIES HAVE SHRUNK, BUT THERE IS STILL AN IMPORTANT GROUP OF THESE COUNTRIES FOR WHOM CURRENT ACCOUNT DEFICITS ARE AN OVER-RIDING POLICY CONSIDERATION. ANOTHER GROUP OF SMALLER INDUSTRIAL COUNTRIES HAS HAD PERSISTENT AND RELATIVELY LARGE SURPLUSES THAT HAVE ALSO CONTRIBUTED TO INSTABILITY IN THE INTERNATIONAL ECONOMY. THE CIRCUMSTANCES OF THE NON-OIL LDCS AS A GROUP HAVE IMPROVED ALTHOUGH A NUMBER OF INDIVIDUAL COUNTRIES STILL HAVE SERIOUS BALANCE OF PAYMENTS PROBLEMS.

THE GERMANS AND JAPANESE SURPLUSES AND THE U.S. DEFICIT IN 1978 COULD EXCEED THOSE RECORDED IN 1977, GIVEN THE J-CURVE RESPONSE OF CURRENT ACCOUNTS TO THE EXCHANGE RATE CHANGES OF 1977 AND EARLY 1978. THE PROSPECTS ARE BETTER FOR SOME ADJUSTMENT OF THESE IMBALANCES IN 1979 AS PAST EXCHANGE RATE CHANGES BEGIN TO HAVE A SIGNIFICANT EFFECT ON TRADE VOLUME. NO DRAMATIC CHANGE IS LIKELY IF GROWTH RATES REMAIN ON THEIR PRESENT COURSE, HOWEVER.

NONRESIDENTIAL INVESTMENT IN FIXED CAPITAL HAS DECLINED SIGNIFICANTLY AS A SHARE OF GNP SINCE 1970 IN ALL OF OUR COUNTRIES EXCEPT CANADA AND FRANCE, AND IN THESE COUNTRIES INVESTMENT GROWTH SLOWED MARKEDLY IN 1977. REAL INVESTMENT SPENDING IS EXPECTED TO GROW MORE RAPIDLY IN OUR ECONOMIES THIS YEAR THAN IN 1977, BUT WE DO NOT FORESEE STRONG PERFORMANCES. PROFITABILITY AND CAPACITY UTILIZATION ARE NOT LIKELY TO BECOME MUCH MORE FAVORABLE TO A STRONG RECOVERY

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OF INVESTMENT IN 1979.

CONSTRAINTS ON IMPROVED ECONOMIC PERFORMANCE

THESE CONSTRAINTS ARE OF THREE TYPES. FIRST IS THE CONSTRAINT IMPOSED BY THE RELATIONSHIP BETWEEN THE RATE OF ECONOMIC GROWTH AND INFLATION. EVEN WHERE THE LIMITS

OF RESOURCES AVAILABILITY HAVE NOT BEEN REACHED, INSTITUTIONAL FACTORS IN THE SETTING OF PRICES AND WAGES SET SOME LIMIT TO THE ECONOMIC GROWTH THAT IS CONSISTENT WITH THE OBJECTIVE OF CONTROLLING OR REDUCING INFLATION. PRESSING TOO CLOSE TO THE LIMITS SET BY THE AVAILABILITY OF LABOR, CAPITAL, AND OTHER RESOURCES, OR MOVING TOWARD THEM TOO RAPIDLY, MAY REKINDLE INFLATIONARY PRESSURES. SECOND, IN ADDITION TO THESE INTERNAL CONSTRAINTS, OBSTACLES TO GROWTH MAY ARISE BECAUSE OF THE HIGH DEGREE OF OPENNESS OF ECONOMIES TODAY. AN EXTERNAL CONSTRAINT IS IMPOSED ON SOME COUNTRIES BY THE NEED TO MAINTAIN SUSTAINABLE CURRENT ACCOUNT POSITIONS AND ON OTHERS BY THE IMPORTANCE OF EXPORT GROWTH TO ACHIEVE A BALANCED EXPANSION. THIRD, THERE ARE POLITICAL AND ECONOMIC CONSTRAINTS ON THE USE OF POLICY INSTRUMENTS. EVEN WHERE THE THREAT OF INFLATION IS NOT AN OBSTACLE TO HIGHER GROWTH, AND WHEN EXTERNAL CONSTRAINTS HAVE BEEN REMOVED, SOME GOVERNMENTS FEEL THAT MEASURES TAKEN BY THEM TO STIMULATE GROWTH MIGHT THEMSELVES SET OFF INFLATIONARY EXPECTATIONS AND PROVE INEFFECTIVE IN INCREASING OUTPUT.

IF INTERNAL CONSTRAINTS WERE THE DOMINANT ONES IN ALL CASES THERE WOULD BE NO SCOPE FOR INTERNATIONAL COOPERATION TO IMPROVE ECONOMIC PERFORMANCE. MOST COUNTRIES TODAY,

HOWEVER, HAVE AT LEAST SOME SCOPE INTERNALLY TO GROW MORE  
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RAPIDLY WHILE STILL PURSUING OBJECTIVES WITH RESPECT TO INFLATION. THE EXTERNAL CONSTRAINTS THAT COUNTRIES FACE COULD BE RELAXED SOMEWHAT BY INTERNATIONAL COOPERATION IN SETTING ECONOMIC POLICIES. MOREOVER, A COOPERATIVE INTERNATIONAL APPROACH TO AN INCREASE IN ECONOMIC GROWTH WOULD REDUCE THE AMOUNT OF GOVERNMENTAL STIMULUS REQUIRED BY AN INDIVIDUAL COUNTRY TO ACHIEVE ANY GIVEN GROWTH OBJECTIVE. THUS, FOR MOST INDUSTRIAL COUNTRIES, RELAXING EXTERNAL CONSTRAINTS WOULD MAKE INCREASED GROWTH POSSIBLE IN 1978 AND 1979. TO ALLOW CONTINUED PROGRESS BEYOND 1979, IT WILL BE NECESSARY TO INTRODUCE POLICIES THAT RELAX COUNTRIES' INTERNAL CONSTRAINTS AS WELL.

INTERNAL INFLATION CONSTRAINT

THE ULTIMATE CONSTRAINT ON ECONOMIC PERFORMANCE IS THE AVAILABILITY OF RESOURCES AND PRODUCTIVITY IN THEIR USE. OUTPUT CANNOT BE PUSHED BEYOND THE LIMITS SET BY AVAILABLE LABOR, CAPITAL, AND NATURAL RESOURCES. MOREOVER, MOVING CLOSE TO THESE LIMITS CAUSES WAGES AND PRICES TO ACCELERATE. OUTSIDE THE UNITED STATES, THERE IS SUFFICIENT SLACK TO ALLOW SIGNIFICANTLY FASTER GROWTH OVER THE NEXT



YR AND A HALF THAN CONTAINED IN THE OUTLOOK ABOVE. OVER THE LONGER TERM, A STRONG INVESTMENT PERFORMANCE AND MEASURES TO LOWER THE RATE OF UNEMPLOYMENT CONSISTENT WITH NON-ACCELERATING INFLATION WILL BE NEEDED TO RELAX INTERNAL CONSTRAINTS ON GROWTH.

THERE DOES NOT APPEAR TO BE AN IMMEDIATE THREAT OF NEW INFLATION FROM EXCESS DEMAND AND TIGHT LABOR MARKETS. IN JAPAN AND GERMANY, INFLATION RATES HAVE SLOWED SUBSTANTIALLY AND ARE NOW AT RELATIVELY LOW LEVELS. GROWTH IN 1978 AND 1979 ABOVE CURRENT PROSPECTS, WOULD NOT ITSELF THREATEN EXCESS DEMAND INFLATION, ALTHOUGH CARE MUST BE TAKEN THAT THE POLICIES TO ACHIEVE MORE RAPID GROWTH BE DESIGNED TO AVOID RAISING INFLATIONARY EXPECTATIONS. IN  
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OTHER COUNTRIES, INFLATION RATES STILL REMAIN HIGH. IN SOME OF THESE COUNTRIES -- BUT NOT THE UNITED STATES -- A SMALL INCREMENT TO GROWTH WOULD NOT IMPEDE FURTHER PROGRESS AGAINST INFLATION. THE UNITED KINGDOM AND ITALY, WHICH HAVE MADE SUBSTANTIAL PROGRESS IN REDUCING INFLATION OVER THE PAST YEAR, BUT IN WHICH RATES OF INFLATION STILL REMAIN HIGH, MUST CONTINUE THEIR EFFORTS. IN FRANCE, WHERE PROGRESS AGAINST INFLATION HAS BEEN LESS, AND IN THE UNITED STATES AND CANADA WHERE THE RATE OF PRICE INCREASE HAS ACTUALLY EDGED UP, RELATIVELY GREATER PRIORITY MUST BE ASSIGNED TO ANTI-INFLATIONARY MEASURES. WITH THIS IN MIND THE UNITED STATES ANNOUNCED IN APRIL A

VOLUNTARY INCOMES POLICY AND IN MAY SCALED BACK AND POSTPONED PROPOSED TAX REDUCTIONS FOR FISCAL YEAR 1979. THE NEED TO REDUCE INFLATION IN OUR COUNTRIES IMPLIES CAUTION IN AVOIDING EXCESSIVELY RAPID GROWTH, BUT IT SHOULD NOT PRECLUDE A GRADUAL REDUCTION OF UNEMPLOYMENT RATES.

EMPHASIS MUST BE GIVEN TO POLICIES THAT ATTACK THE MECHANISMS OF COST/PRICE AND WAGE/WAGE SPIRALS. THE SUCCESS OF SUCH POLICIES WILL HINGE ON ACHIEVING A MODERATION OF INCOME DEMANDS BY ALL GROUPS IN OUR COUNTRIES. THE DIFFICULTIES IN ACHIEVING THIS MUST BE CLEARLY ACKNOWLEDGED. FORMAL WAGE AND PRICE CONTROLS HAVE OFTEN NOT REDUCED THE COMPETITION FOR HIGHER INCOME SHARES, BUT ONLY TRANSFERRED THEM FROM THE MARKETPLACE AND BARGAINING TABLE TO THE POLITICAL ARENA. MOREOVER, CONTROLS, WHERE USED, HAVE LED TO RIGIDITIES IN WAGES AND PRICES THAT HAVE UNDERMINED THEIR ROLE IN ALLOCATING RESOURCES. HENCE, COUNTRIES HAVE RECENTLY RELIED MORE HEAVILY ON PROGRAMS OF VOLUNTARY WAGE AND PRICE MODERATION BACKED UP BY GUIDELINES AND INTENSIVE CONSULTATIONS. GREATER STRESS HAS ALSO BEEN  
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PLACED ON EFFORTS TO REDUCE INFLATION IN THE GOVERNMENT SECTOR. THE UNITED KINGDOM HAS ACHIEVED CONSIDERABLE SUCCESS OVER THE PAST YEAR WITH A PROGRAM ALONG THESE LINES, AND THE UNITED STATES HAS RECENTLY TAKEN STEPS IN THESE DIRECTIONS.

#### EXTERNAL CONSTRAINTS

CURRENT ACCOUNT CONSTRAINT -- WHILE A LARGE CURRENT ACCOUNT DEFICIT IS NOT NECESSARILY A CONSTRAINT ON GROWTH, IT RAISES THE RISK OF A DEPRECIATION OF THE CURRENCY IF THERE ARE ACTUAL OR PERCEIVED PROBLEMS OF FINANCING THE DEFICIT. EXCHANGE RATE CHANGES CAN CONTRIBUTE TO THE ADJUSTMENT OF IMBALANCES AND THUS OBVIATE THE NEED TO REDUCE GROWTH IN ORDER TO KEEP THE CURRENT ACCOUNT WITHIN SUSTAINABLE LIMITS. ATTEMPTS TO RESIST EXCHANGE RATE PRESSURES WHEN THERE ARE LARGE IMBALANCES ARE USUALLY INEFFECTIVE. ON THE OTHER HAND, FAILING TO DEAL WITH THE UNDERLYING PROBLEMS IS COSTLY. DEPRECIATION TENDS TO ADD TO INFLATIONARY PRESSURES AND MAY INVOLVE A HIGH INFLATIONARY COST FOR A SMALL CURRENT ACCOUNT IMPROVEMENT, PARTICULARLY WHERE TRADE INVOLVES A LARGE SHARE OF TOTAL ECONOMIC ACTIVITY AND WHERE WAGE EARNERS ARE WELL PROTECTED AGAINST INFLATION BY INDEXING SCHEMES. IN ADDITION, IMBALANCES CAN BECOME SO LARGE AND SO PERSISTENT THAT A SLOWING OF GROWTH BECOMES AN INDISPENSABLE ELEMENT OF THE ADJUSTMENT PROCESS.

ALTHOUGH A NUMBER OF COUNTRIES ARE IN MUCH IMPROVED

POSITIONS TODAY COMPARED WITH A YEAR AND A HALF AGO, CONCERNS ABOUT THEIR CURRENT ACCOUNTS WOULD PREVENT THEM FROM STRONGLY PURSUING MORE EXPANSIONARY POLICIES. THE UNITED KINGDOM AND ITALY HAVE MOVED INTO SURPLUS AND THE DEFICIT OF FRANCE HAS BEEN REDUCED, BUT MUCH FASTER GROWTH THAN PROJECTED FOR THESE COUNTRIES, WITHOUT CORRESPOND-

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INGLY FASTER GROWTH BY OTHERS, COULD LEAD TO A REEMERGENCE OF CURRENT ACCOUNT PROBLEMS. FOR CANADA, WHICH HAS THE LARGEST EXTERNAL DEFICIT RELATIVE TO GNP AMONG THE MAJOR COUNTRIES, CURRENT ACCOUNT PROBLEMS IMPOSE SOME CONSTRAINT ON GROWTH, BUT INTERNAL CONSTRAINTS APPEAR TO BE DOMINANT AND WOULD INHIBIT POLICIES TO ACHIEVE MORE THAN A MARGINAL INCREASE IN GROWTH EVEN IF THE CURRENT ACCOUNT WERE TO

IMPROVE. ANY SHORTFALL IN GROWTH ABROAD, HOWEVER, WOULD SIGNIFICANTLY TIGHTEN THE EXTERNAL CONSTRAINT IN THE FUTURE. CURRENT ACCOUNT CONSTRAINTS ARE MORE SERIOUS IN SOME OF THE SMALLER COUNTRIES AND A NUMBER OF DEVELOPING COUNTRIES.

CURRENT ACCOUNT DEFICITS WOULD BIND LESS TIGHTLY IF OUR COUNTRIES WERE TO INCREASE THEIR GROWTH RATES BY MODERATE AND VARYING AMOUNTS. EACH COUNTRY COULD THEN ANTICIPATE STRONGER EXPORT GROWTH TO MATCH THE INCREASED IMPORTS RESULTING FROM ADDITIONAL DOMESTIC DEMAND STIMULUS. IN ADDITION, LEADERSHIP BY OUR COUNTRIES IN A COOPERATIVE EFFORT WOULD MAKE POLICIES TO ACHIEVE SOMEWHAT MORE RAPID GROWTH FEASIBLE FOR OTHER COUNTRIES. IT IS NECESSARY FOR COUNTRIES IN SURPLUS TO ENSURE THAT THEIR GROWTH POTENTIAL WITHIN THEIR INTERNAL CONSTRAINTS IS INDEED ACHIEVED. IT SHOULD NOT BE EXPECTED, HOWEVER, THAT COUNTRIES IN SURPLUS WOULD ALONE PROVIDE THE DEMAND STIMULUS TO RAISE WORLD-WIDE GROWTH RATES. RATHER, THEIR ACTIONS WOULD BE PART OF A PROCESS OF RELAXATION OF CURRENT ACCOUNT CONSTRAINTS AS OTHER COUNTRIES WERE ABLE TO EXPORT MORE. WITHIN THE LIMITS IMPOSED BY INTERNAL CONSTRAINTS, OTHER COUNTRIES WOULD THEN BE IN A POSITION TO FOLLOW MORE EXPANSIONARY POLICIES. THESE POLICIES, IN TURN, WOULD SERVE TO ALLEVIATE FURTHER THE EXTERNAL CONSTRAINTS ON OTHER COUNTRIES. THUS A MUTUAL EFFORT TO ACHIEVE FASTER GROWTH IN 1979 COULD

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ADD PERHAPS 1 PERCENT TO THE AVERAGE GROWTH RATE IN EUROPE WHERE EXTERNAL CONSTRAINTS ARE MOST IMPROTANT, WITHOUT EXCEEDING EITHER EXTERNAL OR INTERNAL CONSTRAINTS. SOME COUNTRIES WOULD BE ABLE TO RAISE GROWTH MORE THAN THIS WHILE THERE WOULD ALSO BE A FEW COUNTRIES THAT WOULD BE UNABLE TO DO MORE THAN ACCEPT THE RELATIVELY SMALL ADDITIONAL STIMULUS THEY RECEIVED FROM STRONGER EXPORTS.

ALTHOUGH THE U.S. DEFICIT IS VERY LARGE, IT IS NOT THE LIMITING FACTOR ON U.S. GROWTH. INTERNAL CONSTRAINTS

WOULD PREVENT AIMING FOR HIGHER GROWTH EVEN IF THE DEFICIT WERE TO SHRINK. MOREOVER, SINCE FOREIGN TRADE IS RELATIVELY SMALL COMPARED TO TOTAL U.S. OUTPUT AND SINCE WAGES RESPOND RELATIVELY SLOWLY TO HIGHER IMPORT PRICES, REAL EXCHANGE RATE MOVEMENTS CAN BE AN EFFECTIVE ADJUSTMENT MECHANISM FOR THE UNITED STATES. NEVERTHELESS, IT MUST BE RECOGNIZED THAT GIVEN THE CENTRAL IMPORTANCE OF THE U.S. DOLLAR IN INTERNATIONAL FINANCIAL MARKETS, EXCESSIVE DEPRECIATION OF THE DOLLAR CAN BE A DESTABILIZING FACTOR IN THE WORLD ECONOMY. THUS, STEPS THAT THE UNITED STATES COULD TAKE TO REDUCE ITS DEFICIT CONSISTENT WITH ITS INTERNAL GOALS

WOULD ENHANCE GLOBAL PROSPECTS FOR GROWTH.

GLOBAL ENERGY CONSTRAINT -- OVER THE MEDIUM TERM GLOBAL ECONOMIC GROWTH MAY BE CONSTRAINED BY LIMITED POTENTIAL INCREASED OIL PRODUCTION. A RAPID RISE IN OIL CONSUMPTION COULD REMOVE THE CURRENT GLUT OF OIL AND LEAD TO SHARPLY HIGHER PRICES. FEARS THAT FUTURE GROWTH MIGHT BE LIMITED BY AN OIL CONSTRAINT ALSO TEND TO DEPRESS BUSINESS INVESTMENT IN THE SHORT RUN. THUS MEASURES TAKEN BY COUNTRIES TO REDUCE ENERGY CONSUMPTION AND DEVELOP ALTERNATIVES TO IMPORTED OIL CAN MAKE POSSIBLE STRONGER GROWTH, BOTH FOR THEMSELVES AND FOR OTHERS. THE UNITED STATES MUST PLAY A CENTRAL ROLE IN IMPLEMENTING STRONG ENERGY POLICIES. A REDUCTION OF U.S. OIL IMPORTS WOULD NOT ONLY HELP TO AL-

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LEVIATE THE GLOBAL ENERGY CONSTRAINT BUT IT WOULD ALSO CONTRIBUTE TO A REDUCTION IN THE U.S. CURRENT ACCOUNT DEFICIT WITHOUT POSING THE RISK THAT CURRENT ACCOUNT CONSTRAINTS ON OTHERS WOULD IMPINGE MORE CLOSELY.

CONSTRAINTS ON EXPORTS -- IN A WORLD OF SLOW ECONOMIC GROWTH COUNTRIES WITH CURRENT ACCOUNT SURPLUSES FACE AN OBSTACLE TO MORE RAPID GROWTH FROM SLOW GROWTH OF EXPORT MARKETS. THEIR ABILITY TO SUSTAIN EXPANSION SOLELY FROM INTERNAL DEMAND IS LIMITED BECAUSE OPPORTUNITIES FOR PROFITABLE INVESTMENT ARE RESTRICTED AND THERE IS A RISK THAT SOME SECTORS WOULD REACH CAPACITY WHILE OTHER SECTORS REMAINED DEPRESSED AND UNEMPLOYMENT REMAINED HIGH. MOREOVER, SURPLUS COUNTRIES WITH LOW INTERNAL GROWTH FACE THE THREAT OF SIGNIFICANT EXCHANGE RATE APPRECIATION THAT WOULD DISRUPT MARKETS AND DEPRESS GROWTH PROCESSES. A COOPERATIVE APPROACH TO MORE RAPID GROWTH IN A NUMBER OF COUNTRIES WOULD ALLOW A MORE BALANCED EXPANSION OF OUTPUT.

GOVERNMENT DEFICIT CONSTRAINTS -- ALTHOUGH THE APPROPRIATENESS OF ANY PARTICULAR GOVERNMENT DEFICIT DEPENDS CRUCIALLY ON OTHER ECONOMIC VARIABLES, FOR SEVERAL REASONS GOVERNMENTS ARE INHIBITED FROM ADOPTING EXPANSIONARY FISCAL POLICIES WHEN BUDGET DEFICITS APPEAR LARGE BY HISTORICAL

STANDARDS. A MAJOR CONCERN IS THAT SPENDING PROGRAMS, AND EVEN TAX CUTS, WOULD BE DIFFICULT TO WITHDRAW ONCE INTRODUCED, AND THUS A BUDGET DEFICIT THAT MIGHT BE QUITE APPROPRIATE UNDER CURRENT CONDITIONS WOULD PERSIST INTO THE FUTURE AND WOULD ULTIMATELY LEAD TO OVERHEATING OF AN ECONOMY, MORE RAPID INFLATION, AND CROWDING OUT OF PRIVATE INVESTMENT SPENDING. THUS, STIMULATIVE FISCAL POLICIES COULD HAVE ADVERSE EFFECTS ON INFLATIONARY EXPECTATIONS.

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FISCAL STIMULUS MUST BE DESIGNED TO AVOID THESE RISKS. IN GENERAL, THIS MIGHT SUGGEST A PREFERENCE FOR GENERAL TAX CUTS OVER SPENDING AND TRANSFER PROGRAMS, WHICH ARE POLITICALLY MORE DIFFICULT TO DISMANTLE. IN SOME COUNTRIES, HOWEVER, LARGE LEAKAGES OF TAX CUTS INTO PRIVATE SAVINGS HAVE LED SOME TO QUESTION WHETHER THEY CAN PROVIDE EFFECTIVE STIMULUS. EACH COUNTRY FACES DIFFERENT CIRCUMSTANCES IN MAKING THE CHOICE AS TO WHAT MIX OF FISCAL STIMULUS TO EMPLOY.

A SECOND SOURCE OF CONCERN WITH A LARGE DEFICIT IS THE POSSIBLE INADEQUACY OF COUNTRIES' FINANCIAL MARKETS TO THE SCALE OF FINANCING THAT IS IMPLIED. IF FINANCIAL MARKETS ARE SEGMENTED AND INSTITUTIONAL RIGIDITIES EXIST, IT MAY BE DIFFICULT TO TRANSFER PRIVATE SAVINGS TO FINANCING THE PUBLIC DEFICIT. OVER TIME, DEVELOPMENT OF IMPROVED FINANCIAL INSTITUTIONS AND FINANCING ARRANGEMENTS CAN ALLEVIATE THIS PROBLEM, BUT IN THE NEAR TERM SOME SEE LIMITS ON THE DEFICITS THEIR GOVERNMENTS CAN INCUR WITHOUT STRAINING MARKETS AND JEOPARDIZING THE FLOW OF FUNDS FOR PRIVATE INVESTMENT.

WHATEVER THE EXTENT AND TYPE OF FISCAL STIMULUS A COUNTRY CHOOSES, ADDITIONAL GROWTH RESULTS WILL BE GREATER IF OTHER COUNTRIES ARE ALSO MOVING TO HIGHER GROWTH RATES. A COUNTRY WITH A LARGE TRADING SECTOR WOULD FIND MUCH OF ITS FISCAL STIMULUS DISSIPATED IN HIGHER IMPORTS IF IT WERE TO ACT ALONE. THE HOPED FOR IMPROVEMENT IN THE INVESTMENT CLIMATE WOULD BE LIMITED. AS A PART OF A CONCERTED PROGRAM, HOWEVER, THE DEGREE OF FISCAL STIMULUS NEEDED IN ANY COUNTRY WOULD BE SMALLER, AND TO THE EXTENT THAT THE GOVERNMENT DEFICIT IS A CONSTRAINT, THIS CONSTRAINT COULD BE RELAXED.

MONETARY POLICY CONSTRAINTS -- OUR MONETARY AUTHORITIES HAVE MOVED IN RECENT YEARS TOWARD GIVING MORE ATTENTION

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TO THE MEDIUM-TERM GROWTH OF MONETARY AGGREGATES AS A MEANS OF RESTRAINING INFLATIONARY PRESSURES. THIS SHIFT IN EMPHASIS HAS BEEN INTENDED PARTLY AS A MEANS OF ENSURING THAT MONETARY POLICY IS CONSISTENT WITH REDUCING INFLATION OVER THE MEDIUM TERM. WITHIN THESE SELF-

IMPOSED CONSTRAINTS, HOWEVER, COUNTRIES HAVE AT TIMES

FOUND IT NECESSARY TO TIGHTEN MONETARY CONDITIONS FURTHER TO PREVENT A TOO RAPID OR EXCESSIVE DEPRECIATION OF THEIR CURRENCY. AS A RESULT, THE MIX OF MONETARY AND FISCAL POLICIES HAS RETARDED INVESTMENT SPENDING RELATIVE TO OTHER FORMS OF SPENDING. AT THE SAME TIME, COUNTRIES WITH APPRECIATING CURRENCIES HAVE OCCASIONALLY FOUND THEIR CONTROL OVER MONETARY GROWTH RATES THREATENED BY THE NEED TO INTERVENE IN EXCHANGE MARKETS IN ORDER TO RESTORE ORDER.

CONCERTED POLICIES TO ACHIEVE GROWTH RATES AMONG MAJOR COUNTRIES CONSISTENT WITH A REDUCTION IN CURRENT ACCOUNT IMBALANCES WOULD PERMIT MONETARY POLICIES TO BE SET MORE CLOSELY IN LINE WITH DOMESTIC NEEDS.

POLITICAL AND REGULATORY HINDRANCES TO INVESTMENT -- CHALLENGES TO PLANNED GOVERNMENT AND PRIVATE SECTOR INVESTMENT EITHER IN THE POLITICAL PROCESS OR IN REGULATORY AND LEGAL PROCESSES, OFTEN BECAUSE OF ENVIRONMENTAL CONCERNS, HAVE HELD DOWN THE GROWTH OF EXPENDITURES IN SOME CASES. THE EFFECT ON SPENDING HAS BEEN QUANTITATIVELY MOST IMPORTANT IN GERMANY, BUT IT HAS ALSO BEEN A FACTOR IN THE UNITED STATES AND ELSEWHERE. UNCERTAINTIES ASSOCIATED WITH REGULATORY PROCESSES MAY ALSO HAVE INHIBITED PRIVATE INVESTMENT EVEN WHEN IT HAS NOT BLOCKED IT.

NEW APPROACHES TO THESE PROBLEMS WILL BE NEEDED. FIRST,  
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GOVERNMENTS SHOULD CONSIDER REGULATORY ANALYSIS PROGRAMS, SO THAT THE ECONOMIC AND INFLATIONARY CONSEQUENCES OF REGULATIONS WILL MORE EXPLICITLY BE TAKEN INTO ACCOUNT, AND COST EFFECTIVE SOLUTIONS ADOPTED TO DEAL WITH SOCIAL AND ENVIRONMENTAL PROBLEMS. EVEN WITH IMPROVED ANALYSIS AND PROCEDURES, IT IS LIKELY THAT NEW SOCIAL AND ENVIRONMENTAL CONCERNS WILL LEAD TO SOME DELAYS AND HIGHER COSTS. THEREFORE, MORE OPTIONS FOR PUBLIC PROJECTS AND NEW INCENTIVES FOR PRIVATE INVESTMENT MAY BE NEEDED TO COMPENSATE FOR THE NEW RISKS AND HIGHER COSTS ARISING FROM NEW CONCERNS AND TO MAINTAIN ADEQUATE INVESTMENT. THE NEGATIVE IMPACT ON THE GROWTH OF DEMAND CAN ALSO BE OVERCOME IN THE SHORT RUN BY STIMULUS TO OTHER KINDS OF SPENDING, PUBLIC OR PRIVATE.

FEASIBLE ECONOMIC OBJECTIVES

THE PATHS THAT OUR ECONOMIES ARE LIKELY TO FOLLOW THROUGH 1979 IF CURRENT POLICIES ARE MAINTAINED WOULD BE UNSATISFACTORY IN SEVERAL RESPECTS. UNEMPLOYMENT IS UNLIKELY TO COME DOWN SIGNIFICANTLY AND MAY CONTINUE RISING IN EUROPE AND JAPAN. EXCESS CAPACITY WOULD REMAIN

SUBSTANTIAL. SUCH AN OUTCOME WOULD HAVE SEVERAL CONSEQUENCES. FIRST, OF COURSE, WOULD BE THE TRAGEDY OF UNEMPLOYMENT -- PARTICULARLY AMONG THE YOUNG WHOSE DEVELOPMENT INTO PRODUCTIVE MEMBERS OF THE LABOR FORCE IS BEING DELAYED. SECOND WOULD BE THE CONTINUED LOSS OF MATERIAL WELL-BEING, WITH LOWER INVESTMENT AND CONSUMPTION AND DELAYS IN MEETING IMPORTANT SOCIAL AND ECONOMIC OBJECTIVES. THIRD, LOW RATES OF CAPACITY UTILIZATION WOULD CONTINUE TO LIMIT INVESTMENT DEMAND AND THEREBY LOWER THE TREND OF POTENTIAL OUTPUT AND EMPLOYMENT. FOURTH, COSTS OF ADJUSTMENT TO LONGER TERM STRUCTURAL CHANGES IN PATTERNS OF DEMAND AND SUPPLY WOULD BE HIGHER THAN IF THE CAPITAL AND LABOR THAT WAS NO LONGER NEEDED IN ONE INDUSTRY COULD BE  
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IMMEDIATELY EMPLOYED IN GROWING INDUSTRIES. UNDER CONDITIONS OF WEAK OVERALL DEMAND THERE ARE STRONG PRESSURES TO ADOPT DEFENSIVE POLICIES THAT CARRY RISKS OF INHIBITING ADJUSTMENT FURTHER, RIGIDIFYING ECONOMIES AND RENDERING THEM LESS PRODUCTIVE AND MORE PRONE TO INFLATION. FINALLY, EACH YEAR OF SLOW GROWTH AND HEIGHTENED UNCERTAINTY RESULTS IN A FURTHER SHORTFALL OF CAPITAL ACCUMULATION AND RAISES THE SPECTRE OF FUTURE SUPPLY CONSTRAINTS AND STRUCTURAL UNEMPLOYMENT.

AT THE SAME TIME THAT THE GROWTH OF OUTPUT WOULD BE LESS THAN ATTAINABLE WITH AVAILABLE RESOURCES, INFLATION WOULD CONTINUE TO BE AN IMPORTANT PROBLEM IN MOST COUNTRIES. GIVEN THE SUCCESS ALREADY ACHIEVED IN BRINGING DOWN UNEMPLOYMENT IN THE UNITED STATES, AND WITH THE PERSISTENCE OF INFLATION AT RATES OF 6 TO 7 PERCENT, INFLATION IS THE RELATIVELY MORE URGENT PROBLEM -HERE. ONLY IN JAPAN AND GERMANY CAN THE SHORT-RUN INFLATION SITUATION BE GIVEN A RELATIVELY LOW WEIGHT IN CURRENT ECONOMIC POLICY DECISIONS. OF COURSE, THESE COUNTRIES TOO MUST AVOID ACTIONS THAT WOULD LEAD TO SIGNIFICANTLY GREATER INFLATIONARY PRESSURES IN THE FUTURE.

THE OUTLOOK FOR THE PERIOD AHEAD ALSO ENTAILS CURRENT ACCOUNT IMBALANCES THAT COULD CONTINUE TO BE A DESTABILIZING FACTOR IN THE WORLD ECONOMY. THUS, THEY POINT TOWARD SERIOUS RISKS OF FURTHER DISTURBANCES IN EXCHANGE MARKETS THAT COULD PREVENT THE ACHIEVEMENT OF EVEN THE MODEST GROWTH IN THE OUTLOOK SKETCHED ABOVE. SUCH DISTURBANCES COULD LEAD TO WORSE THAN PROJECTED INFLATION RATES IN SOME COUNTRIES AND DISRUPT EXPORT INDUSTRIES IN OTHERS.

THE GROUP HAS EXPLORED THE SCOPE FOR IMPROVING ON THE  
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CURRENT OUTLOOK AND CONSIDERED WHAT MEASURES WOULD CONTRIBUTE TO A BETTER OUTCOME. IN DOING SO IT HAS PAID CLOSE ATTENTION TO THE CONSTRAINTS ON ECONOMIC POLICIES

AND RESULTS.

GIVEN THE CONSTRAINTS, IT DOES NOT SEEM POSSIBLE TO ERADICATE OUR ECONOMIC PROBLEMS QUICKLY. WE DO NOT EXPECT THAT ONE SET OF MEASURES PUT IN PLACE THIS YEAR WILL BE SUFFICIENT TO RESOLVE THE CURRENT PROBLEMS. IT HAS BEEN THREE YEARS SINCE THE TROUGH OF THE RECESSION AND SOME OF THE ORIGINS OF THE CURRENT CONSTELLATION OF ECONOMIC PROBLEMS CAN BE TRACED BACK AT LEAST TEN YEARS. GOVERNMENTS HAVE TAKEN STEPS TO DEAL WITH THE PROBLEMS, OFTEN WITH A NOTICEABLE EFFECT, BUT THEY HAVE NOT YET BEEN ERADICATED. MANY ECONOMIES HAVE BECOME SO ADAPTED TO SLOW GROWTH AND IDLE RESOURCES THAT A SUSTAINED IMPETUS TO DEMAND MAY BE NEEDED BEFORE THE AUTONOMOUS FORCES OF EXPANSION BECOME STRONG ENOUGH TO MAINTAIN GROWTH, LET ALONE POSE THE NEED FOR WIDESPREAD ACTION. MOREOVER, IT IS CLEAR THAT INFLATION WILL NOT BE UNWOUND QUICKLY AND THAT THE MECHANISMS THAT CREATE AND SUSTAIN INFLATION IN THE FACE OF EXCESS DEMAND WILL NOT BE DISMANTLED EASILY. SIMPLY BECAUSE SOLUTIONS WILL TAKE TIME, IT IS ESSENTIAL TO BEGIN IMMEDIATELY AND MAKE PROGRESS AS RAPIDLY AS POSSIBLE.

THE GROUP AGREES THAT THE FOLLOWING PRINCIPLES SHOULD GOVERN THE DEVELOPMENT OF NATIONAL POLICIES AS A PART OF A COOPERATIVE INTERNATIONAL EFFORT:

1. THE DEVELOPMENT OF A COMMON STRATEGY FOR MORE GROWTH AND EMPLOYMENT MUST BE REGARDED AS THE CHIEF TASK OF INTERNATIONAL ECONOMIC POLICY. ALL COUNTRIES SHOULD PURSUE POLICIES OF PROMOTING GROWTH AS FAR AS THEIR INTERNAL CONSTRAINTS PERMIT. IN ACCORDANCE WITH THE DIFFERENT NATIONAL STARTING POINTS AND RELATIVE ECONOMIC POSITIONS,

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THE SCOPE FOR ACTION AVAILABLE WILL OF COURSE DIFFER FROM COUNTRY TO COUNTRY.

2. TO SUSTAIN RECOVERY AND ATTAIN FULL UTILIZATION OF RESOURCES REQUIRES THAT WE CONTINUE TO MAKE PROGRESS IN REDUCING AND CONTROLLING INFLATION. IN COUNTRIES WHERE INFLATION IS NOW LOW, WE SHOULD AVOID REKINDLING



INFLATIONARY PRESSURES. IN COUNTRIES WHERE INFLATION REMAINS HIGH THE GOAL SHOULD BE TO REDUCE INFLATION IN 1979 THROUGH APPROPRIATE FISCAL AND MONETARY POLICIES AND MEASURES TO DEAL WITH STRUCTURAL IMPEDIMENTS TO PRICE STABILITY.

3. GOVERNMENTS SHOULD ENSURE THAT GROWTH OCCURS IN WAYS THAT PROVIDE SUFFICIENT SCOPE AND INCENTIVES FOR INVESTMENT; TAX INCENTIVES FOR INVESTMENT MAY BE NECESSARY. EACH OF OUR COUNTRIES SHOULD SET AS A GOAL RAISING THE

SHARE OF INDUSTRIAL INVESTMENT IN GNP IN 1979.

4. POLICIES TO ACHIEVE MORE SUSTAINED GROWTH AND BETTER CONTROL OF INFLATION WILL SUPPORT THE ACHIEVEMENT OF GREATER STABILITY IN EXCHANGE MARKETS. IN ADDITION, BOTH COUNTRIES WITH SIZABLE SURPLUSES AND DEFICITS SHOULD WORK TO REDUCE THESE PAYMENTS IMBALANCES AND THUS AVOID EXTREME EXCHANGE RATE FLUCTUATIONS.

5. PRESSURES TO RESORT TO PROTECTIONISM OR INCREASED GOVERNMENT INTERVENTION MUST BE RESISTED BY OUR GOVERNMENTS. OFTEN, THESE PROP UP OR SUBSIDIZE UNECONOMIC INDUSTRIES, POSTPONING INEVITABLE STRUCTURAL ADJUSTMENTS. IN THE LONG RUN, SUCH A COURSE ENDANGERS PRODUCTIVITY AND THE GROWTH OF LIVING STANDARDS. IN PLACE OF SUCH  
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POLICIES, COUNTRIES SHOULD INTRODUCE POLICIES TO PROMOTE STRUCTURAL ADJUSTMENT THROUGH MEASURES THAT AID ITS TRANSFER OF LABOR AND CAPITAL TO MORE PRODUCTIVE, FAST GROWING SECTORS. PROTECTIONIST MEASURES SHOULD ALSO BE AVOIDED WITH A VIEW TO ASSURING A GROWTH IN WORLD MARKETS FOR THE PRODUCTS OF DEVELOPING COUNTRIES.

6. OUR COUNTRIES AND OTHERS MUST PURSUE VIGOROUS POLICIES OF ENERGY CONSERVATION AND A DEVELOPMENT OF NEW ENERGY RESOURCES WITH PARTICULAR EMPHASIS ON MEASURES THAT WILL REDUCE OIL IMPORTS.

ELEMENTS OF A COOPERATIVE INTERNATIONAL EFFORT TO IMPROVE ECONOMIC PERFORMANCE

TO BE COMPLETED AFTER FURTHER DISCUSSIONS. VANCE

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